

THE ECONOMIC DEVELOPMENT REPORT CARD FOR MONTGOMERY COUNTY, MARYLAND 2005

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
<u>EMPLOYMENT CONDITIONS</u>									
Employment Growth	B-	A	A	A	B	B	B	B	A
The Labor Market	A-	A	A	A	B+	B+	B+	B+	A
The Work Force		B	B-	B	B	B	B	B-	B-
<u>THE ECONOMIC BASE</u>									
Highly Skilled, Knowledge-Based Economy	A+	A+	A+	A+	A+	A+	A+	A+	A+
Professional and Business Services	B	B+	B+	A	B	B+	B	B	A
Federal Contracting	B+	B+	B-	B	B-	A-	B+	A+	B+
The Retail Sector	A	B+	B	A-	B	B	B+	B+	A-
<u>THE BUSINESS ENVIRONMENT</u>									
Business Attraction and Retention	B+	B	A-	A	B-	B	B+	A	A
County Tax Structure	B+	B+	A-	A-	A-	B-	B-	B-	B
<u>CONSTRUCTION AND DEVELOPMENT CAPACITY</u>									
Non-Residential Construction	D	D	C+	B+	A-	A-	B+	B	B-
Residential Development	C-	B	B	B	B	A-	A-	A-	B-
<u>PUBLIC SERVICES AND PUBLIC SECTOR CAPACITY</u>									
Income Tax Receipts	A	A	A	A	B	C	B	A	A
The Property Tax Base	C	C	C	B-	B	B+	B+	A	A
Public Expenditures vs. Revenue Capacity	B	A	A	A	C	C	C	C	B-
Transportation Capital Expenditures		C-	D	D-	F	D	D	D	C+

By

The Economic Development Report Card Committee
Of the Economic Advisory Council of Montgomery County
In conjunction with the Montgomery County
Department of Economic Development
September, 2006

THE 2005 ECONOMIC DEVELOPMENT REPORT CARD
FOR MONTGOMERY COUNTY, MARYLAND

PRINCIPAL FINDINGS

1. The County economy grew rapidly in 2005, adding 9,800 jobs and resuming its position of the late 1990's as the key job engine in Maryland's economy. The County's 2.2 percent job growth was among the fastest of all major jurisdictions. The Committee awards the County high Report Card grades in 2005, reflecting the broad-based strength in the County's economy and its overall fiscal health.¹
2. Employment in the professional and business services sector, a key driver of the County economy, increased 4.9 percent in 2005 and contributed to overall private sector employment growth of 2.6 percent. Job growth was robust in financial services, retail services, and health and education sectors. Legal services, research and development firms, architecture and engineering services, and commercial banking all exhibited strong growth. Wages are now increasing more than 5 percent annually in professional job categories.
3. The County's programs for business attraction remain successful, and its grant and loan programs to small businesses continue to generate long-term employment gains in the County. The County opened business incubators in Silver Spring in 2005 and Wheaton in early 2006, as part of a major expansion of incubators in the County. A set aside program was enacted that earmarks 10 percent of County procurement dollars for small Montgomery County firms. The County must continue to focus on providing a business environment that effectively competes with other jurisdictions: avoiding unnecessarily complex and restrictive regulations, providing incentives and financial assistance that attract more venture capital and facilitating more technology transfer are all important areas to focus attention.
4. The County's efforts to foster strong job growth helped increased demand for commercial space in 2005 and early 2006, resulting in sharply lower vacancy rates. The vacancy rate for Class A space declined to 6.6 percent in the first quarter of 2006 versus 10 percent 18 months earlier. Office completions dropped to 0.8 million square feet in 2005, reflecting the cessation of new starts two to three years earlier. Continued growth in employment will gradually translate into increasing new building starts in the next two years.
5. The year marked a transition from sharply rising demand and rising housing prices in 2005 to a softer market in 2006, and major uncertainties in the regulatory environment. Median single family housing prices increased 16.5 percent in 2005, to levels 70 percent higher than four years earlier. Buyer caution in 2006 has led to a softer housing market

¹ The Economic Development Report Card was established in 1996 to measure economic performance in the County. The Committee, appointed each year by County Executive Douglas Duncan, awards 'grades' that assess performance in many aspects of economic performance and economic development policy.

and growing inventories of unsold homes. Housing completions declined to 3,700 units in 2005. The aftermath of disputes over builder compliance and zoning regulation in Clarksburg has been long delays in decision-making, and uncertainty over process and the timing of decisions. While some zoning and permitting issues in Clarksburg remain unresolved, the larger fallout remains. Building permits have declined sharply, with permits issued in the County from July 1, 2005 through March 31, 2006 59 percent below levels of a year earlier, reflecting both market conditions and regulatory processes. A much lower level of housing completions is likely in 2006.

6. Rapid growth in housing demand and prices over the last several years has created an increasingly serious housing availability problem. A growing fraction of the County's workforce, including many in skilled, professional positions, cannot afford to live in the County. Employers are finding it more and more difficult to attract workers, especially young workers. The County should develop a more aggressive strategy to expand the housing stock, including zoning changes that allow higher density development and the expansion of programs that require a higher fraction of work force housing to be included in new developments.
7. Property tax rate reductions in both FY06 and FY07 to keep within the Charter limit lowered overall property tax collections by \$86 million in FY06 and are projected to increase by \$128 million in FY07. The average tax bill has increased less than 4 percent annually during these two fiscal years. Expanded tax credits for lower price homes provided disproportionate tax relief to households with below average home values and incomes. The County is to be applauded for this equity adjustment in the County's property tax structure.
8. The County enjoys very rapid growth in tax revenue, led by large increases in income and transfer taxes. Public expenditures are increasing rapidly, by 8.1 percent in FY07 and an 8.0 percent average over the three fiscal years FY05-FY07. Expenditures on public safety increased 14 percent in the FY07 budget. This rate of growth of total expenditures exceeds the growth in wage and salary earnings and appears unsustainable over the long run. The County should reduce the rate of growth in its operating budget.
9. Rapid growth in compensation costs for County employees is traceable to growth in the number of work years of County employees and rising average compensation costs per employee. Employee costs are now 80 percent of the County's overall budget. County full-time equivalents (FTEs) will increase 3 percent in FY07. More than one-half of the work year increase is account for by expansion in public safety departments (Corrections, Police, and Fire and Rescue). Average compensation costs per employee are estimated to increase by 9.1 percent in FY07, and have grown faster than private sector earnings over the last 10 years. Reducing the rate of growth in both the County workforce and averaged earnings per employee will be necessary in the near future to meet reasonable spending targets.
10. Reducing the growth of public spending and shifting funds from operating to capital budgets would make an important contribution to the County's economic future. Capital

budgets were increased 24 percent in the CIP for FY07-FY12 from the previous biannual capital budget, a significant first step toward expanding public infrastructure.

11. The County has taken the most significant actions in 2005 and 2006 toward improving transportation since the late 1980s. The most critical step was the approval of a 23 percent increase in the transportation capital budget for the period FY07-FY12. The additional capital funds will allow the County to aggressively bargain and “cost share” with the State, and therefore obtain more State construction funding for major improvements in the State road system. A sustained commitment to large increases in transportation investments is required for many years into the future if the County is to make progress toward improving transportation service.
12. With all federal approvals now completed, construction on the InterCounty Connector (ICC) is slated to begin in the fall of 2006, with a targeted completion in 2010. The ICC is financed with federal and State funds, together with user tolls, but without any County tax revenues.

EMPLOYMENT CONDITIONS

National and Regional Economic Conditions The national economy enjoyed sustained growth in 2005, with employment growth accelerating nationally and in the region. A continuing and broadening national economic expansion led firms to significantly increase employment in 2005. The recent period of employment growth contrasted to an earlier period during this economic recovery when firms had been able to expand output by relying on higher productivity from their existing work force and had been very cautious in adding new positions.

Increased employment and earned income contributed to growing consumer demand. Continued moderate rates of inflation and low long-term interest rates, together with a booming housing market, added to household liquidity, even as the Federal Reserve increased short-term interest rates and mortgage interest rates began to climb from historic lows during 2003 and 2004. Domestic demand was more than adequate to offset a growing trade deficit. There is little to fault in the economy's overall economic performance in 2005, though increasing federal deficits remain a threat to the economy over the long term.

Notwithstanding sharply rising energy costs, a softer housing market, and rising interest rates, employment demand and economic growth remained robust in the first part of 2006. More recently, higher energy costs, an increase in the core inflation rate, and some further increases in interest rates will likely translate into slower economic growth in the second half of 2006, as the Federal Reserve acts to forestall an increase in inflationary expectations. Near-term uncertainties about when the monetary "tightening" cycle will end continue to create some nervousness in financial markets in mid 2006. Economic growth will be slower in 2006 than in 2005 as financial markets adjust to further increases in short-term interest rates and consumers restrain discretionary spending to pay for higher energy costs. Employment growth continues in 2006, though at a somewhat slower rate, as unemployment rates fall and consumer demand growth slows.

Long term economic prospects remain excellent, reflecting high rates of productivity growth, low core inflation rates, and unrelenting world-wide competition. These favorable factors will likely dominate the next several years, even as the long term global demand for energy translates into further and likely significant energy price increases. If the Federal Reserve is successful in reducing inflationary expectations, the economy should enjoy continued expansion in 2007 and beyond.

The State of Maryland and the Washington region enjoyed rapid employment growth, with the Washington region exceeding that of any major metropolitan area in the nation. The region's extraordinary work force and a growing share of federal procurement translated into a robust private sector and strong demand for labor. Employment increased 2.3 percent in the Washington region and 1.5 percent in the State of Maryland in 2005 and the first quarter of 2006. Maryland's employment growth is likely to track that of the nation in the immediate future. Montgomery County's economy, the largest employment center in the State of Maryland and an important part of the Washington region, typically follows these same trends.

Employment Growth

The County economy grew rapidly in 2005, adding an estimated 9,800 jobs. This 2.2 percent increase (compared to 2.3 percent for the Washington region) is a very strong performance for Montgomery County (Table 1). The sharp growth in employment in the County in 2005 is especially noteworthy since the County's job growth is typically below that of the Washington region and Northern Virginia. Private sector jobs increased at a 2.6 percent rate in the County in 2005, versus 1.8 percent in the State of Maryland (Table 2). The County has again resumed its position as the leading economic driver of the State economy.

Table 1						
Total Employment in Montgomery County, State of Maryland, and the Washington, D.C. Region						
(Jobs in 000's)						
Montgomery County Jobs				% Change, Other Areas		
<u>Year</u>	<u>Total</u>	<u>Change</u>	<u>% Change</u>	<u>State</u>	<u>Wash. Region</u>	<u>Northern VA</u>
1996	388,400	4,000	1.0%	1.3%	2.2%	3.7%
1997	399,500	11,100	2.9%	2.5%	2.7%	3.3%
1998	413,600	14,100	3.5%	2.5%	2.9%	4.2%
1999	426,200	12,600	3.0%	2.9%	3.6%	5.5%
2000	447,500	21,300	5.0%	2.7%	4.8%	6.4%
2001	449,900	2,400	0.5%	0.6%	1.7%	1.5%
2002	451,800	2,000	0.4%	0.4%	0.3%	-0.7%
2003	449,800	-2,100	-0.5%	0.4%	2.5%	1.1%
2004	448,700	-1,100	-0.5%	1.1%	2.9%	4.6%
2005	458,600	9,900	2.2%	1.5%	2.3%	3.6%
<i>Source: Maryland Department of Labor, Licensing and Regulation</i>						
<u>Quarter</u>	<u>Jobs</u>	<u>Change</u>	<u>% Change</u>	<u>State</u>	<u>Wash. Region</u>	<u>Northern VA</u>
2005.1	450,900	9,400	2.1%	1.4%	2.6%	3.9%
2005.2	460,600	9,800	2.2%	1.6%	2.3%	3.6%
2005.3	457,700	11,100	2.5%	1.4%	2.2%	3.5%
2005.4	465,200	10,300	2.3%	1.4%	2.0%	3.2%
2006.1				1.5%	2.6%	3.7%
<i>Source: Maryland Department of Labor, Licensing, and Regulation, and the U.S. Department of Labor</i>						
<i>*2006 first quarter County data not yet released.</i>						

Table 2 Private Sector Employment Growth % Change		
Year	Montgomery County	State
1996	1.9%	1.7%
1997	4.1%	3.1%
1998	4.1%	2.5%
1999	3.4%	2.9%
2000	5.7%	3.0%
2001	0.1%	0.5%
2002	0.0%	0.0%
2003	0.3%	1.4%
2004	1.4%	1.5%
2005	2.6%	1.8%

Source: Maryland Department of Labor, Licensing and Regulation

After a period of little or no job growth from 2002 to 2004, employment in the County is approximately 10,000 jobs higher than the pre-recession peak in 2002². The County's job growth in 2005 places it among the fastest growing larger counties in the State. Among the six largest jurisdictions in the State (Anne Arundel County, Baltimore City, Baltimore County, Howard County, Montgomery County, and Prince George's County), only Anne Arundel County experienced faster job growth in 2005 than Montgomery County. Prince George's County's economy continued to stagnate in 2005, with virtually no increase in private sector employment since 2000. It is likely that the number of workers commuting into Montgomery County from Prince George's County will increase over time.

County employment has been increasing faster than in the State since the first quarter of 2005, a return to the pattern in the 1997-2000 period of faster employment growth in the County than in the State. Leading indicators of business activity suggest that the County will likely grow faster than the State as a whole in the immediate future, with employment growth in the County likely in the 1.5 - 2 percent range in 2006.

Goal: Achieve employment growth in 2006 of 2.0 percent, the target in the County's 2003 Strategic Plan for Economic Development.

The Labor Market

The tone of the labor market both nationally and in the region has changed significantly over the last 18 months, as firms resume hiring and unemployed and under-employed workers are absorbed. The national unemployment rate increased less during the most recent recession than expected, principally because labor force growth slowed nationally as discouraged workers withdrew from the work force. Renewed demands for labor are now attracting workers back into the work force.

This same process is underway in the County, though the County's unemployment rate never approached the level of unemployment rates nationally. The acceleration in employment growth in the County has reduced the County's unemployment rate from its recent "peak" of 3.1 percent in 2004. The County's unemployment rate remains the lowest in the State, falling to 3.1 percent in 2005, and to 2.8 percent in the most recent month, May, 2006 (Table 3).

² This is only an approximation since reported employment data by place of work and by county in the 2001-2003 period were slightly distorted by reporting issues arising when firms report their data using a different industry code or report employment at an establishment site in another county even though no relocation in actual employment took place.

Table 3		
Rate of Unemployment		
<u>Year</u>	<u>County</u>	<u>State</u>
1997	2.6%	5.1%
1998	2.3%	4.6%
1999	1.8%	3.5%
2000	1.9%	3.8%
2001	2.3%	4.0%
2002	2.8%	4.4%
2003	2.6%	4.5%
2004	3.1%	4.2%
2005	3.1%	4.1%
Jan 2006	3.0%	4.1%
Feb 2006	2.7%	3.8%
Mar 2006	2.5%	3.5%
Apr 2006	2.5%	3.4%
May 2006	2.8%	3.7%

Source: Maryland Department of Labor, Licensing and Regulation

Howard, Frederick, and Calvert Counties reported the same unemployment rate as Montgomery County in May, 2006. While Montgomery County has relatively little surplus labor to absorb, it is likely that the County's unemployment rate will fall further as the current economic expansion continues. An unemployment rate in the County below 2 percent is likely by late 2007.

Goal: Maintain an unemployment rate at or below the lowest level of all counties in the State.

The Workforce

The County has a highly educated work force. According to the 2000 Census, 27 percent of all residents 25 and over hold advanced degrees, and another 27 percent are college graduates, placing the County among the most educated in the nation. The ability to attract a high-quality work force to meet the employment needs of both private and public sector employers is critical to successful economic development. The long-term need for workers spans a wide economic spectrum, including the most educated and skilled professional and managerial workers, a broad range of technicians, and a wide range of skills among service sector workers in health care, social and educational services, and retail-oriented occupations.

Housing Costs The challenges that the County faces in attracting a work force are long term in nature. Employers report that it is difficult to attract and retain workers, traceable in large part to an affordable housing shortage, the high cost of moving into the County, and expensive, often lengthy commutes from surrounding jurisdictions. The solutions lie in promoting long term policies: expanding the housing stock, increasing the number of workforce housing units, improving accessibility to the County from surrounding jurisdictions, and investing in the education of all residents, particularly those nearing entry to the work force or who are already in the workforce.

Reducing housing costs in the County by increasing supply will be difficult. Housing prices will likely remain high for the foreseeable future, reflecting the quality of life in the County, economic opportunities, and the shortage of housing and buildable land. Addressing the housing shortage is controversial, since some regard an increase in housing as exacerbating the accessibility problem. Reaching a consensus in the County about how to increase the housing stock will require confronting difficult issues and equity concerns, notably balancing the interests of current housing owners versus the benefits of extending opportunities to others who could

contribute to the County economy. Huge increases in housing prices over the last several years have worsened the housing affordability problem, and employees in every sector state that it is increasingly difficult to recruit workers at all income levels.

Education Success in education is vital to the long term success of the County; today's students are its future workforce. The County's workforce is largely from this region and has been educated here: according to the 2000 Census, among college graduates ages 25-35 presently working in the Washington region, only 30 percent lived outside the region five years earlier. For workers above 35, the proportion of in-migrants is only about half this level.

The County's education system is superb at all levels, and the County's long term commitment to supporting high quality education is one of the principal determinants of the quality of the County's workforce over the long run. Expansion of its post-secondary educational facilities will make important contributions in the future. Providing training to those already in the workforce, particularly the rapidly growing immigrant population in the County, is critically important.

Transportation Increasing transportation congestion makes commuting into the County very costly, especially east-west commuting. Improving transportation accessibility - and achieving success by reducing commuting costs - will be very difficult. It will require accelerating the County's investment in transportation, a strategy that will be expensive and will yield results only over the long run. In addition to investing in more transportation, the County must play an active role in promoting regional solutions that provide the critical inter-regional infrastructure needed to serve a large, mobile, regional work force.

Goal: Expand and train the County's resident work force through educational and training programs coordinated with industry needs. Expand the housing stock and increase the rate of investment in transportation infrastructure, including regional approaches to transportation and employment accessibility.

Education and the Work Force

The County enjoys continuing successes in education, with major contributions being made by educational institutions at every level in educating the County's future - and present day - work force. Montgomery County Public Schools (MCPS) provide a superb education to a large and increasingly diverse student body, with results that far exceed many urban school districts with similar student compositions. While total student enrollment in MCPS has been virtually flat the last two years, MCPS is experiencing a dramatic transformation in the demographic composition of students, with the student body becoming increasingly diverse, including much higher fractions of African American and Hispanic students and a larger number of students (9 percent) with English as a second language (Table 4).

White students comprised 42 percent of the fall 2005 student body. Hispanic students are the fastest growing portion of the student body, increasing 3.7 percent in the 2005-2006 year and now comprising 20 percent of all students.

Table 4 Public School Enrollment - Increasing Diversity					
<u>School Year</u>	<u>Total</u>	<u>White</u>	<u>Asian</u>	<u>Hispanic</u>	<u>African American</u>
1993-94	113,429	65,749	14,014	12,260	21,009
1998-99	127,852	66,409	16,380	17,815	26,820
2003-04	139,203	62,072	19,908	26,058	30,736
2004-05	139,339	60,300	20,100	27,000	31,500
2005-06	139,387	58,500	20,500	28,000	31,900
% Change 1 year Student Composition	0.0%	-3.0%	2.0%	3.7%	1.3%
Student Composition 2005-2006	100.0%	42.0%	14.7%	20.1%	22.9%
<i>Students with Special Needs in Academic Year 2005-06:</i>					
English as a Second Language					9.3%
Free and Reduced Price Meal Services					25.8%
Special Education					12.3%
<i>Source: Montgomery County Public Schools</i>					

The County's efforts to improve the quality of education are proving very successful. A County program initiated in 1999 targets elementary schools with the most challenging socioeconomic composition, offering all day kindergarten, smaller classes, and more specialized reading and math training, resulting in dramatic improvements in student learning. The County continues to upgrade its curriculum and raise standards and expectations. This year 3,800 fifth grade students, more than one third of the class, are completing pre-algebra instruction that was given at the sixth grade five years earlier.

SAT test scores in the County remain at very high levels, and scores for white and Asian students have increased significantly in the last two years (Table 5). Scores by African-American and Hispanic students remain relatively stable. Increasing achievement scores for all racial and ethnic groups is an especially important continuing challenge.

MCPS are increasing the number and range of challenging courses, and dramatically increasing the number of students who are taking Advanced Placement (AP) courses for which they can receive college credits. Fifty-three percent of graduating seniors in the Class of 2005 had taken at least one AP exam, up from 40 percent four years earlier (Table 6). The number of African-American and Hispanic students taking at least one AP test almost doubled over this four year period. Similar increases have occurred in the number of students earning at least one grade of three (accepted for college credit at many institutions). In both SAT and AP tests, the performance of African-American and Hispanic students in Montgomery County far exceeds levels achieved in schools nationally.

Table 5
Montgomery County SAT Scores - Increasing SAT Scores with Widening Differences Across Ethnic Groups

<u>Year</u>	<u>% Tested*</u>	<u>Total</u>	<u>White</u>	<u>Asian</u>	<u>Hispanic</u>	<u>African American</u>
1994-1995		1,087	1,137	1,124	996	940
1999-2000		1,093	1,152	1,123	962	914
2000-2001	72%	1,092	1,154	1,127	949	911
2001-2002	74%	1,095	1,159	1,138	950	906
2002-2003	74%	1,094	1,153	1,127	945	917
2003-2004	73%	1,102	1,163	1,160	944	917
2004-2005	76%	1,101	1,174	1,163	942	917

Source: Montgomery County Public Schools, an examination of SAT results for the Class of 2005

**The County defines the participation rate as the percentage of the graduating class that takes an SAT test.*

Table 6
Percentage of MCPS Graduating Students Taking at Least One AP Exam

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>% of MCPS Graduates Scoring 3 or Higher on AP Exam (2005)</u>
African American	16.9%	19.2%	23.7%	26.2%	29.2%	17.2%
Asian American	54.4%	61.5%	1.0%	68.8%	71.0%	57.4%
Hispanic	21.5%	25.9%	2.9%	32.5%	38.2%	32.8%
White	49.5%	54.8%	55.9%	60.3%	62.8%	53.3%
Free and Reduced Meals	13.7%	20.1%	23.3%	28.3%	32.2%	22.1%
Special Education	8.5%	12.1%	13.7%	12.6%	15.7%	11.2%
Limited English Proficient	9.3%	11.4%	10.4%	24.0%	27.4%	21.7%
MCPS Class Total*	40.4%	45.4%	47.7%	51.5%	53.7%	43.6%

Source: Montgomery County Public Schools

**Includes American Indian Students*

Post-secondary education institutions continue to expand their programs. Montgomery College and the Universities at Shady Grove are making valuable contributions to building the County's future workforce. Montgomery College continues to expand its curriculum, and its enrollment has increased 6 percent over the last five years. Enrollment was steady in 2005, but 2 percent more credits were taken as the number of full time students increased. Montgomery College enrolled 24 percent of MCPS graduates in 2005.

The programs at the Universities at Shady Grove, a cooperative effort of many of the four year institutions in the State, enroll 2,050 students, with a full-time undergraduate daytime enrollment of 756 students, 11 percent more than the prior year. The program at Shady Grove is near

capacity with its current two buildings, and further growth will await completion of its third building, expected to be completed in the fall of 2007.

Goal: Improve the performance of all students, close the gap in achievement by ethnic group and school and expand the range of programs and number of students enrolled at Montgomery College and at the Universities at Shady Grove.

THE ECONOMIC BASE

Highly Skilled, Knowledge-Based Economy

The County's long-term success depends critically on its competitive standing in the leading export-oriented sectors that, in turn, generate resources that support other County businesses and resident incomes. Knowledge-based industries are the dominant part of the export-oriented portion of the economy-- industries whose markets are based on innovation, discovery, and the application of technology and knowledge to create and market new goods and services. A highly educated and skilled workforce is central to the success of these sectors. Traditionally, manufacturing and professional and business services have been the core of the export sector.

The County has the premier employment base of the State, based on a stable core of growth-inducing sectors that effectively compete in national and international markets. The County's outstanding workforce underlies this success. The County's principal export-oriented sectors include a wide range of professional, business, and financial services, federal government employment, and a small high-tech manufacturing sector.

The County has the highest concentration of employment in professional and business services in the State, accounting for 26 percent of employment in the professional and business services sector (Table 9). Financial and information services are also leading export-oriented sectors concentrated in the County.

Average earnings overall in the export-oriented sectors are approximately \$80,000 (Table 9). Reported average earnings includes both full and part time workers (i.e., all employees of a firm working any portion of a year appear in the data), hence reported average earnings of full time workers is considerably higher than the reported average for all employees shown in Table 9.

Federal employment is an important part of the County's economy. The federal government employs 40,000 persons in the County, with a predominance of professional and scientific employees at the National Institutes of Health, the Food and Drug Administration (FDA), the National Oceanic and Atmospheric Administration and other science-based organizations. Average earnings of federal employees in the County were \$89,000 in the fourth quarter of 2005, an increase of 7.9 percent from the prior year.

Professional and business services and financial services led employment expansion in the export-oriented sector in 2005 (Table 10). Manufacturing continues to lose jobs, principally the result of job reductions in computer and electronic products, which make up more than one-half

of the County's manufacturing base. Employment is increasing at more than a 10 percent annual rate in the pharmaceuticals and medicines manufacturing sector. Federal employment has

Table 9				
The Employment Composition of Montgomery County, Fourth Quarter 2005				
<u>Sector</u>	<u>Employment</u>	<u>County % of State Total</u>	<u>2005 Average Earnings</u>	<u>% Change, 2001-2005</u>
Total	466,228	18.4%	\$57,616	18.3%
Total Private Sector	385,650	18.7%	\$55,328	17.4%
Selected Private Sub-sectors:				
Construction	30,076	16.1%	\$59,072	17.6%
Manufacturing	14,570	10.4%	\$78,104	13.1%
Transportation Trade & Utilities	66,828	14.0%	\$39,780	9.8%
Information	15,494	30.0%	\$81,848	25.3%
Financial Activities	36,149	22.9%	\$80,756	40.4%
Professional and Business Services	103,099	26.6%	\$68,016	13.7%
Education and Health Services	57,427	16.6%	\$48,100	20.3%
Leisure and Hospitality	38,908	17.4%	\$25,480	10.4%
Other Services	21,815	24.5%	\$34,424	14.9%
Total Government	25,578	16.3%	\$68,692	23.6%
Federal Government	39,745	31.5%	\$89,024	35.9%
State Government	1,043	1.1%	\$37,960	26.7%
Local Government	38,789	16.2%	\$48,724	5.2%

Source: Maryland Department of Labor, Licensing and Regulation

declined marginally over the last two years, but is likely to remain steady or increase as the FDA campus in White Oak is completed.

Table 10							
Change in Federal Government, Manufacturing, Professional and Business Service Jobs in Montgomery County							
	Federal Government			Manufacturing		Prof. & Business Services	
<u>Year</u>	<u>Jobs</u>	<u>% Change</u>	<u>Jobs</u>	<u>% Change</u>	<u>Jobs</u>	<u>% Change</u>	
1994	43,781	-3.6%	16,414	6.4%	66,453	-0.9%	
1995	42,595	-2.7%	16,229	-1.1%	68,256	2.7%	
1996	41,427	-2.7%	14,471	-10.8%	73,107	7.1%	
1997	39,191	-5.4%	15,626	8.0%	77,149	5.5%	
1998	38,817	-1.0%	15,594	-0.2%	83,121	7.7%	
1999	39,066	0.6%	15,848	1.6%	88,116	6.0%	
2000	39,616	1.4%	17,242	8.8%	95,802	8.7%	
2001	40,397	2.0%	18,809	*	96,029	*	
2002	41,179	1.9%	17,392	-7.5%	95,640	-0.4%	
2003	41,189	0.0%	16,222	-6.7%	95,898	0.3%	
2004	40,656	-1.3%	15,454	-4.7%	96,426	0.6%	
2005	39,969	-1.7%	14,710	-4.8%	101,117	4.9%	

Source: Maryland Department of Labor, Licensing and Regulation

*2000 and 2001 data not comparable due to changes in sub industry coding.

Earnings Growth With the expansion in employment since late 2004, earnings growth has accelerated in the County. Average earnings per worker increased 6 percent in 2004 and 4.6 percent in 2005, well above growth rates in earlier years (Table 11). These increases reflect the resumption of hiring and the necessity of County firms to bid aggressively to recruit and retain workers. Expansion of employment in the County is dominated by bidding for highly educated and skilled workers, where there is more competition for workers. Competition for workers is far more intense in the County than in labor markets nationally at present, and above average wage growth for County employees in the immediate future seems likely.

Table 11
Average Annual Montgomery County
Earnings
1994-2005

Year	Average Earnings	% Change	
	Per Worker	County	State
1994	\$33,759	2.5%	1.0%
1995	\$34,693	2.8%	2.6%
1996	\$35,991	3.7%	3.9%
1997	\$37,667	4.7%	4.9%
1998	\$39,657	5.3%	4.9%
1999	\$41,301	4.1%	3.6%
2000	\$43,671	5.7%	5.5%
2001	\$45,821	4.9%	5.0%
2002	\$47,260	3.1%	3.0%
2003	\$48,874	3.4%	3.4%
2004	\$51,794	6.0%	4.5%
2005	\$54,161	4.6%	4.3%

Source: Maryland Department of Labor, Licensing and Regulation

Earnings levels continue to diverge by education and skill level, with earnings growing at a much lower rate for less skilled and less educated workers, and at much faster rates for the more highly skilled portion of the County's workforce (see Table 9). The fastest earnings growth over the four year period 2001-2005 occurred in financial services (40 percent), information (25 percent), and federal employment (36 percent). Reported earnings growth for professional and business services was a deceptively "low" 14 percent, largely because approximately one-third of this sector includes firms providing administrative and operations activities, with significantly lower average pay levels and below average wage growth. The pattern of a widening in the distribution of earnings across skill levels that is evident in the County data follows trends nationwide of widening disparities in incomes.

Goal: Promote further growth in highly skilled, professional job sectors.

Professional and Business Services

The end of 2004 marked a turning point in the County economy and the beginning of a broad-based surge in employment in virtually all major areas providing professional and business services. Employment increased sharply in 2005 among these firms, marking a turning point after several years of only moderate growth in this critical sector (Tables 12-15). According to the State's employment statistics, growth in the County's professional and business services sector increased 4.9 percent in 2005 versus 3.4 percent statewide.

Two-thirds of this sector, categorized as professional and technical services, includes firms providing a broad range of technical services: legal, research and development, engineering and architectural services, management consulting, advertising, and accounting services. The professional services sector also includes many firms engaged in federal contracting.

Table 12				
Employment in Professional and Technical Services				
County			Washington Region	
<u>Year</u>	<u>Jobs (000)</u>	<u>% Change</u>	<u>Jobs (000)</u>	<u>% Change</u>
1997	49.5	4.2%	282.8	4.6%
1998	52.2	5.5%	300.6	6.3%
1999	55.8	6.9%	325.2	8.2%
2000	60.1	7.7%	353.7	8.8%
2001	62.1	*	369.2	4.4%
2002	63.5	2.3%	366.5	-0.7%
2003	61.9	-2.6%	380.4	3.8%
2004	61.1	-1.2%	400.6	5.3%
2005	63.8	4.4%	422.4	5.4%
<i>Source: Maryland Department of Labor, Licensing and Regulation</i>				
<i>*2000 and 2001 data not comparable due to changes in sub-industry coding.</i>				

Table 13				
Employment in Computer System Design and Related Sectors				
County			Washington Region	
<u>Year</u>	<u>Jobs (000)</u>	<u>% Change</u>	<u>Jobs (000)</u>	<u>% Change</u>
1996	12.6	3.1%	74.3	4.3%
1997	13.6	7.9%	82.2	9.7%
1998	15.3	12.5%	91.5	11.3%
1999	17.6	15.0%	102.5	12.0%
2000	19.6	11.4%	114.1	11.3%
2001	19.1	*	114.5	0.4%
2002	18.9	-0.8%	112.3	-1.9%
2003	18.7	-1.4%	121.1	7.8%
2004	16.9	-9.5%	129.3	6.8%
2005	17.6	3.8%	134.7	4.2%
<i>Source: Maryland Department of Labor, Licensing and Regulation</i>				
<i>*2000 and 2001 data not comparable due to changes in sub-industry coding.</i>				

Table 14				
Employment in the Scientific Research and Development Sector				
County			Washington Region	
<u>Year</u>	<u>Jobs (000)</u>	<u>% Change</u>	<u>Jobs (000)</u>	<u>% Change</u>
1997	6.7	6.3%	36.7	2.5%
1998	6.4	-4.5%	0.01	-0.3%
1999	6.5	1.6%	0.03	3.6%
2000	7.4	13.8%	40.1	5.8%
2001	10.6	*	42.1	5.0%
2002	11.9	12.6%	42.1	0.0%
2003	12.3	3.0%	43.5	3.3%
2004	12.5	1.8%	46.4	6.7%
2005	13	4.0%	51.3	10.6%
<i>Source: Maryland Department of Labor, Licensing and Regulation</i>				
<i>*2000 and 2001 data not comparable due to changes in sub-industry coding.</i>				

Table 15				
Employment in the Financial Activities Sector				
County			Washington Region	
<u>Year</u>	<u>Jobs</u>	<u>% Change</u>	<u>Jobs</u>	<u>% Change</u>
1997	29.3	1.2%	132.8	2.6%
1998	30.0	2.3%	138.9	4.6%
1999	31.2	4.0%	143.3	3.2%
2000	31.9	2.2%	145.8	1.7%
2001	33.7	5.6%	148.0	1.5%
2002	33.7	-0.2%	151.2	2.2%
2003	35.4	5.1%	155.9	3.1%
2004	34.6	-2.3%	157.4	1.0%
2005	36.1	4.4%	161.0	2.3%
<i>Source: Maryland Department of Labor, Licensing and Regulation</i>				
<i>*2000 and 2001 data not comparable due to changes in sub-industry coding.</i>				

Employment increased 4.5 percent among firms in professional and technical services. Growth rates were rapid in the major subcategories, including computer systems design (3.8 percent), research and development (4 percent), and management and technical consulting (11.5 percent). Legal services employment increased more than 5 percent in 2005, continuing a strong trend of recent years. Employment increased more than 3 percent in architectural and engineering services firms, reflecting continued activity in residential markets and renovation activity. An increase in business travel in the County also contributed to an increase in employment in hotels. Job gains were also significant in financial services, a sector in which employment has increased faster in Montgomery County than in the State of Maryland or the Washington region since 2000 (Table 15). Growth accelerated at depository credit intermediation firms (notably commercial

banking) in 2004 and 2005. Employment growth continued in securities firms in 2005, though at a slower rate than the prior three years. Employment in the real estate sector increased more than 5 percent in 2005, reflecting the feverish residential housing market. In summary, 2005 exhibited an extraordinary expansion in the County's leading professional and business service sectors.

Goal: Support continued growth in professional and business services.

Federal Contracting

Federal contracting is a significant part of the professional services base of the County, and recent growth in contracting activity in the County is a major success story. Federal contracting awards to County firms increased only 1.5 percent in FY05, but this followed a 34 percent increase in FY04 (Table 16). Federal contracts in the County are now 90 percent higher than in FY01, with County firms increasing their share of procurement in the Washington area since 2001.

Year	County		Washington Region	
	<u>Total</u>	<u>% Growth</u>	<u>Total</u>	<u>% Growth</u>
FY93	\$2,730,703	-1.1%	\$16,139,579	1.7%
FY94	\$2,751,439	0.8%	\$17,876,310	10.8%
FY95	\$3,328,579	21.0%	\$19,375,499	8.4%
FY96	\$3,195,492	-4.0%	\$21,059,930	8.7%
FY97	\$3,244,770	1.5%	\$22,004,032	4.5%
FY98	\$3,554,097	9.5%	\$24,410,269	10.9%
FY99	\$3,444,326	-3.1%	\$26,238,228	7.5%
FY00	\$3,787,672	10.0%	\$29,231,792	11.4%
FY01	\$3,514,633	-7.2%	\$31,400,000	7.4%
FY02	\$4,728,146	34.5%	\$36,100,000	15.0%
FY03	\$4,867,000	2.9%	\$42,200,000	16.9%
FY04	\$6,600,000	34.4%	\$50,013,000	18.4%
FY05	\$6,700,000	1.5%	\$51,700,000	3.4%

*Source: GSA Federal Procurement Data Center
Data tabulations by George Mason University and M-NCPPC Research and Technology Center*

Federal contracting is focused on very challenging problems in data processing, information technology, telecommunications, and management of complex public sector responsibilities, much of it related to defense and homeland security. The federal government's need to process very large data sets on a very short-time basis, and to make information available to multiple parties while still maintaining security, present very challenging issues. Federal contracting activities are increasingly dominated by larger firms with a successful track record with interested agencies, often with contractors located in close proximity

and having constant contact with agency staff. These activities provide continuing opportunities for County firms that have both expertise and a long-standing reputation of excellence in working with many agencies.

Goal: Promote growth in federal procurement in the County equal to that in the Washington region.

The Retail Sector

Retail sales have been increasing at about a 6 percent rate in the County since 2004, though they have increased at less than the State-wide level for much of the last decade. Employment in retail trade rose only marginally in the State in 2005 - 0.5 percent - but increased significantly in the County - 2.9 percent (Tables 17-18).

Table 17 Growth in Retail Sales Tax Collections			
<u>Year</u>	<u>Total</u>	<u>County</u>	<u>State</u>
1994	\$293.1	7.7%	7.4%
1995	\$300.0	2.4%	3.6%
1996	\$311.7	3.9%	3.0%
1997	\$305.1	-2.1%	5.3%
1998	\$316.4	3.7%	3.9%
1999	\$335.8	6.1%	8.1%
2000	\$358.0	6.6%	8.2%
2001	\$371.6	3.8%	3.0%
2002	\$375.2	0.9%	1.6%
2003	\$390.0	4.0%	3.5%
2004	\$416.2	6.7%	9.1%
2005	\$437.1	5.0%	6.4%
2006	-	4.7%	6.7%
<i>Source: Montgomery County Department of Finance</i>			
<i>Note: * Data for 2006 are through May, 2006</i>			

The strong retail sales market in the County over the last three years finally induced County firms to expand their work force. While sales in the County lag the rest of the State, the significant addition to retail employment in the County signifies a very healthy retail sector.

This surge in County employment in the retail sector is unlikely to be replicated in 2006 and beyond, and retail sales are likely to be adversely affected by higher energy prices in 2006. More

importantly, long-term pressures on retail margins and the very competitive market conditions in most retail sectors leave firms little opportunity to increase payrolls. Even with significant sales gains, retailers in both the County and the State have been reducing employment since 2000 and promoting higher worker productivity and lower unit labor costs. Annual retail employment growth of 0.5 - 1 percent is a more likely outcome in 2006 and beyond.

Goal: Growth in retail sales comparable with the State, reflecting the County's high income level and economic growth targets equal to the State.

THE BUSINESS ENVIRONMENT

Business Attraction and Retention

The 2003 Strategic Plan for Economic Development specifies a target annual employment growth rate of 2 percent (averaged over multi-year assessment periods). The plan includes strategies for targeted County investment to promote business growth and retention in key sectors, and support for continued investment in education and transportation infrastructure.

The County continues to make progress toward these goals. A number of very visible public and private investments recently completed in the County are proving to be major successes and

Table 18 Growth in Retail Employment 1996-2004		
<u>Year</u>	<u>County</u>	<u>State</u>
1997	3.3%	1.2%
1998	1.4%	0.6%
1999	2.1%	2.5%
2000	2.1%	2.0%
2001	-1.1%	-0.7%
2002	0%	0.3%
2003	-1.8%	0.3%
2004	-2.6%	2.7%
2005	2.9%	0.5%
<i>Source: Maryland Department of Labor, Licensing and Regulation</i>		

represent a significant contribution to the County's infrastructure. The completions in 2004 of the Montgomery County Conference Center and the Strathmore Center for Performing Arts, both state-of-the-art facilities, will provide long term benefits to the County. The Conference Center, which opened in November, 2004 has established a record of profitable operations. The County also continues to benefit from the ongoing consolidation and expansion of the FDA onto its campus in White Oak. Over 2,000 employees are already onsite, with a total of 8,500 expected by 2010.

The County's strategies for recruiting and retaining businesses continued to prove effective in 2005, and the Department of Economic Development (DED) tracked over 150 businesses that either relocated to or expanded in Montgomery County. These new and expanding businesses retained, added, or are projected to add about 7,000 jobs, and leased, purchased, or constructed over 3 million square feet of commercial space. DED played a direct role in assisting over 30 of these new and expanding businesses.

The use of strategic financial incentives such as the Economic Development Fund (EDF) illustrates the County's commitment to retaining and attracting top quality businesses. Since its inception in 1995, the EDF, which is administered by DED, has disbursed over \$23 million in loans and grants to 133 businesses. These businesses have retained or created over 32,000 jobs, leased or constructed over 3,000,000 square feet of commercial space, and generated \$1.37 billion in private capital investment. In EDF Report Year 2006 (March 15, 2005 – March 14, 2006), eight EDF offers were made to businesses. Four of these transactions closed during this period, resulting in 488 retained jobs, 140 attracted jobs, and 111 jobs projected to be created in the next one – three years. These successful EDF projects also resulted in over \$5 million in private capital investment. Among the most notable EDF recipients in 2005 was Worldspace, the international satellite radio company that the County attracted to Silver Spring. Worldspace leased 52,000 square feet of newly-constructed office space, bringing over 100 high-paying jobs and \$20 million in capital investment.

As part of the 2003 Strategic Plan, the County continues to successfully target businesses in the advanced technology fields. While the general perception is that Montgomery County's advanced technology sector is focused mainly on the life sciences, it bears noting that of the top 20 new and expanded businesses in the County in 2005, half were information technology related businesses (telecom, satellite, internet, software, aerospace, etc.) (Table 19). These companies – including Startec Global Telecom, CIS Global, Current Technologies, Worldspace, and Thales Communications – employ or are projected to employ nearly 900 people in the next one - five years. The County also continues to be one of the largest and most successful biotech regions in the U.S., attracting and retaining Xceleron, MacroGenics, and Canon USA Life Sciences. The hospitality sector was another 2005 County success story, with the successful attraction of Meristar Hotels and Resorts and the expansion of HMS Host. The County's strong business climate also resulted in a significant decrease in business closures and layoffs in 2005 as compared to 2004. According to State data, only six County companies announced major layoffs or plant closures in 2005.

Top County Successes in 2005

<u>Company</u>	<u>Existing Jobs</u>	<u>Forecasted Expansion 1-5 Years</u>	<u>Total Jobs</u>
HMS Host	488	100	588
First Advantage Safe Rent	250	70	320
Macy's	0	300	300
Startec Global Telecom	122	110	232
Xceleron	2	200	202
CIS Global	150	25	175
Current Technologies	60	60	120
Meristar Hotels	0	108	108
Worldspace	0	108	108
Macrogenics	52	64	116
Kai Research	55	10	65
Intelsat General Corporation	0	50	50
Qbit	18	30	48
Thales Communication	26	20	46
GranDesign	20	15	35
Canon USA Life Sciences	0	30	30
FreeWebs	10	18	28
Italkbb	0	25	25
Bioset	8	10	18
Intelliworks	0	10	10
<i>Total</i>			2,624

Source: Montgomery County Department of Economic Development

The County has been a leader in the State in supporting and promoting startup firms, especially in the biotech and information technologies sectors. The County has the most extensive incubator program in the State, and its loans and grants to small businesses have yielded significant benefits, as noted above. Notwithstanding these successes, there remain continuing challenges to support new firms, to attract venture capital, and to promote technology transfer.

The County's incubator program has been a major driver of new job growth in the County since the program's inception in 1999. There are currently three incubator facilities operating – the Maryland Technology Development Center in Rockville, the Silver Spring Innovation Center, and the Wheaton Business Innovation Center (opened in early 2006), which collectively house over 75 early stage

and start-up businesses employing nearly 300 people. All three facilities are operating close to full capacity, and since 2000, over 30 incubator companies have 'graduated.' These graduates have leased over 330,000 square feet of commercial office and lab space and created over 1,110 high paying County jobs. The County's incubator program will continue to expand in 2006 and beyond with the opening of the Rockville Incubator and the ongoing design and construction of incubators in Germantown and eastern Montgomery County.

The County has one of the largest concentrations of small biotech firms in the nation. However, attracting venture capital remains difficult for the many small firms that are developing products and technologies that are far from commercial viability. Given the successes of the County's incubators and its EDF loan and grant programs, a more aggressive approach that provides more financial support to more companies would appear warranted.

The County Council also created a new program in 2005 intended to help create more procurement opportunities for County based small businesses. The Local Small Business Reserve Program, which went into effect on January 1, 2006 and is administered by DED, requires County departments and agencies to earmark 10 percent of their annual procurement dollars for small businesses.

Goal: Promote strategies in the County's 2003 Strategic Plan for Economic Development, encouraging private sector development and private/public sector partnerships.

County Tax Structure

Previous studies have demonstrated that the County's tax structure, as measured by the combination of all types of taxes, is competitive with surrounding jurisdictions. The most important current taxation issue facing the County is the appropriate level and structure of property tax rates, a pressing issue given the rapid increases in property assessments. Pressure to reduce property tax rates will continue to be intense, given the very large increases in property tax assessments in recent years.

The Committee's view on this issue remains, as in the past, that a combination of general rate reduction, circuit breaker provisions and other credits that provide tax relief to lower income property owners is the appropriate approach³. Current fiscal conditions in the County are such that the County can afford to remain within the Charter limit on property tax growth, and continued expansion of targeted property tax relief is merited on equity grounds. The County stayed within the Charter limit in FY06 and will do so again in FY07, an outcome strongly endorsed by this committee. The County also granted significant tax relief to owners of lower-priced homes. The Committee applauds the County's recent decisions on rate reductions and targeted tax relief.

The Committee again recommends that the County consider whether its income tax rate should be reduced to pre-recession levels, now that temporary revenue shortfalls associated with the recession have long passed. A reduction in the income tax rate to its pre-recession level, phased in over two or more years, would not threaten the quality of public services given the unexpected tax revenues that are being realized annually.

Goal: Continue to assure that the County has a competitive tax structure.

³ The County's Charter limit on property tax increases enacted in 1990 (Section 305 of the Montgomery County Charter) limits property tax revenue increases to the sum of new real property assessments plus an increment on the existing property tax base equal to the Consumer Price Index. This limit can be overridden by a 7-2 super majority in the County Council, on a showing that the cost of paying for critical services exceeds monies that would be collected by adherence to the Charter limit.

CONSTRUCTION ACTIVITY AND DEVELOPMENT CAPACITY

Non-Residential Construction

The market for commercial construction in the County tightened considerably in 2005, with strong job growth increasing demand at a time when little new space was being completed. According to CoStar, 578 companies signed new, renewal, or expanded leases in 2005. One hundred and forty-six of these lease signings were for greater than 10,000 square feet. In comparison, 461 companies signed leases in the County in 2004, 134 of which were transactions for more than 10,000 square feet. Growing demand and very little new supply is now reducing vacancy rates. Vacancy rates have been declining in the County from their peak in late 2003 (and in the Washington region since their peak at the end of 2002). According to data from CoStar, vacancy rates for office space in the County declined from 9.1 percent in the first quarter of 2005 to 7.3 percent in the first quarter of 2006 (Table 20).

Table 20				
Office Vacancy Rates (Percent)				
	<u>All Office</u>	<u>Class A</u>	<u>Class B</u>	<u>Class C</u>
1997-1 st *	8.5	5.8	6.6	*
1998-1 st *	7.9	6.2	5.8	*
1999-1 st *	5.9	4.6	0.0	*
2000-1 st *	6.5	5.0	0.0	*
2001 -1 st *	5.3	5.1	4.3	*
2001-2 nd *	7.2	6.3	5.3	*
2001-3 rd *	7.3	7.2	6.0	*
2001-4 th	9.1	9.5	6.0	5.9
2002-1 st	9.3	9.4	6.8	6.3
2002-2 nd	9.7	10.5	7.2	5.6
2002-3 rd	10.1	10.6	7.8	5.5
2002-4 th	10.9	10.6	8.2	6.9
2203-1 st	8.2	9.9	8.4	6.6
2003-2 nd	10.6	9.8	8.5	8.5
2003-3 rd	11.0	10.2	8.7	7.8
2003-4 th	11.2	10.5	8.6	7.0
2004-1 st	10.7	10.6	9.0	7.3
2004-2 nd	10.3	10.1	9.2	7.4
2004-3 rd	9.7	9.5	9.1	6.7
2004-4 th	9.4	9.5	8.4	7.9
2005-1 st	9.1	7.7	8.6	7.3
2005-2 nd	8.8	8.8	9.3	6.7
2005-3 rd	8.4	8.2	9.0	6.7
2005-4 th	7.6	7.4	8.2	6.0
2006-1 st	7.3	6.6	8.2	6.6
Office Space Inventory 2006 (millions of square feet)				
Total Space	60.8	29.4	25.7	5.8
Vacant Space	4.5	1.9	2.1	0.4
Source: Realty Information Group-CoStar				
*Earlier reports. Comparability with current data is affected by changes in how properties are classified.				

The reduction in vacant space over this period was 1.1 million square feet, enough to serve approximately 4,000 jobs. The decline in the vacancy rate for Class A space, approximately one-half of the office space in the County, was even larger, with the vacancy rate falling to 6.6 percent in the first quarter of 2006 from 10 percent 18 months earlier. The vacancy rate for space available for sublet has fallen to 1.2 percent (from approximately 2.5 percent during the economic slowdown), another sign that market conditions are much tighter than in the recent past. While demand increases are absorbing vacant space, commercial rents have increased only moderately to date. Average asking rents increased by only 3 percent in the year ended in the first quarter of 2006, both in total space and in Class A space. Rents remain marginally below peak levels reached in 2001. With tightening supply conditions and rising demand associated with continued job growth, a faster increase in rents for commercial space seems likely over the next 18 months.

Commercial construction activity was virtually at its low point in this building cycle in 2005, with little space being completed and very few new starts. Completions in 2004 and 2005 were far below levels consistent with long term job growth targets of approximately 9,000 jobs annually. With the virtual cessation of new starts after 2002, commercial completions in the 2003-2005 time period are well below trend levels. Approximately 2.9 million square feet of commercial space (office, retail, and industrial) was completed in 2004 and 2.2 million square feet in 2005, almost one-third below the average of the previous four years, 1999-2003 (Table 21). Completions of commercial space (office, retail, and industrial) averaged almost 3.5 million square feet annually over the period 1999-2003, an indication of the extent of the current decline. Office space completions declined to 1.2 million square feet in 2004 and to only 800 thousand square feet in 2005.

More than the usual uncertainty exists in predicting the outlook for the immediate future. Growing employment is increasing demand, the basis for future development activity. At the same time, developers now confront significantly higher costs and other uncertainties. The willingness of prospective tenants to pay higher rents is one such uncertainty, given that rent increases to date have been modest. Rising interest rates are increasing capital costs during the construction phase, and higher long term rates will add to the full cost of delivered space over the long run. Buildable land remains at a premium. Prices for building materials increased dramatically in 2005 and continue to rise, and the cost of tenant improvements and build-out for quality space are high and rising, with build-out costs for quality facilities often \$40-45 per square foot.

Finally, zoning and permitting processing costs are much higher and far more uncertain in the aftermath of the Clarksburg debacle. Builders state that it is now harder to do business with greater delays, uncertainty on the part of public officials about who has the authority to make particular decisions, and increased demands for documentation and review. It has been suggested that the costs to private developers of site plan approval will soon be several times the levels of a couple of years ago.

Table 21
Commercial Completions in
Montgomery County, 1985-2003
(000 SF)

<u>Year</u>	<u>Total</u>	<u>Office</u>	<u>Retail</u>	<u>Industrial</u>	<u>Other</u>
1985	6,058	4,079	782	752	445
1986	7,014	4,733	1,050	799	392
1987	5,078	2,905	932	596	645
1988	4,005	1,607	937	1,305	160
1989	4,405	2,581	619	1,158	46
1990	2,491	1,173	576	509	232
1991	3,048	950	1,017	933	149
1992	1,129	576	309	103	130
1993	2,738	1,716	766	90	167
1994	706	206	280	56	164
1995	1,373	236	780	285	71
1996	1,237	80	766	219	172
1997	2,135	400	1,064	241	429
1998	2,592	432	915	651	593
1999	3,699	1,404	559	610	1,126
2000	3,033	1,708	510	534	282
2001	4,592	2,627	704	718	544
2002	3,857	2,134	601	864	258
2003	3,280	1,852	397	306	724
2004	2,895	1,233	585	187	890
2005	2,230	769	632	187	642

Source: M-NCPPC

The long-run future of the market for commercial space will be determined by job growth and the environment for developers to provide additional supply, with commercial rent levels reflecting the long run supply and demand conditions. Meeting the targets for new space is a critical element in meeting the County's long term economic development goals.

Goal: Maintain non-residential completions in the office, retail, and industrial categories above 3.5 million square feet annually over the long run to support current employment growth targets.

Residential Development

The year 2005 marked a notable transition in the County's housing market, with market conditions changing significantly by year's end. Equally important, the regulatory framework guiding residential development has undergone a dramatic change, from an environment with long established and well-understood processes to a situation in which regulatory review involves uncertain outcomes and unpredictable waiting periods for decisions. The combination of a short run, unsold inventory of homes and regulatory uncertainty will result in significantly lower levels of housing completions in the immediate future.

The peak of the market in 2005 reflected a combination of economic prosperity and job opportunities, low interest rates and a liberal financial environment, and strong preferences for many to move into the County. Strong demand continued through the end of the summer in 2005. Single family housing prices increased 16.5 percent in 2005, the fourth year of very large increases (a 70 percent increase over the prior four years, 2001-2005) (Table 22). The median sale prices for new units (\$775,000 for new detached units and \$499,000 for new attached units) are approximately 40-50 percent above prices for existing units. With limits on development and high land prices, new development is increasingly dominated by expensive homes.

Rapid growth in housing demand and prices over the last several years has created an increasingly serious housing availability problem. Employers are finding it more and more

difficult to attract workers, especially young workers. Rising prices principally affect households who are moving within the County, and persons relocating into the County because of a change in job site or family circumstances. Moving rates are highest for young households and first-time buyers, who bear the brunt of the burden of sharply rising prices. For households remaining in place, higher prices increase their wealth but also increase their costs for property taxes and insurance.

Table 22
Montgomery County Housing Sales Prices (Median price, \$000)

Year	New SF Detached		Existing SF Detached		New SF Attached		Existing SF Attached		All Single Family	
	\$	% Change	\$	% Change	\$	% Change	\$	% Change	\$	% Change
1989	\$287.0	24.3%	\$200.0	15.6%	\$145.5	22.2%	\$118.0	15.7%	\$145.0	
1990	\$318.9	10.8%	\$207.0	3.5%	\$158.3	8.9%	\$126.0	6.8%	\$166.5	14.8%
1991	\$309.0	-2.8%	\$208.0	0.5%	\$146.0	-7.8%	\$128.0	1.6%	\$170.0	2.1%
1992	\$319.8	0.3%	\$217.0	4.3%	\$185.7	27.2%	\$128.5	0.4%	\$172.9	1.7%
1993	\$343.8	3.2%	\$217.0	0.0%	\$180.9	-2.6%	\$130.0	1.2%	\$182.5	5.6%
1994	\$312.5	-0.1%	\$220.0	1.4%	\$180.3	-0.3%	\$131.0	0.8%	\$187.0	2.5%
1995	\$343.8	7.6%	\$220.7	0.3%	\$199.6	10.7%	\$130.0	-0.8%	\$190.0	1.6%
1996	\$312.5	-9.1%	\$225.0	1.9%	\$169.9	-14.9%	\$132.0	1.5%	\$189.5	-0.3%
1997	\$343.3	9.9%	\$230.0	2.2%	\$174.0	2.4%	\$134.9	2.2%	\$187.0	-1.3%
1998	\$361.7	5.4%	\$235.0	2.2%	\$218.6	25.6%	\$137.0	1.6%	\$197.0	5.3%
1999	\$364.2	0.7%	\$243.0	3.4%	\$212.2	-2.9%	\$139.0	1.5%	\$205.0	4.1%
2000	\$390.6	7.3%	\$262.9	8.2%	\$262.4	23.6%	\$142.7	2.7%	\$217.5	6.1%
2001	\$436.5	11.7%	\$289.0	9.9%	\$265.9	1.1%	\$155.8	9.0%	\$236.1	8.5%
2002	\$481.3	10.3%	\$340.0	17.6%	\$278.0	4.7%	\$185.5	19.0%	\$282.9	19.8%
2003	\$590.8	22.7%	\$385.0	13.2%	\$364.2	31.0%	\$229.0	23.4%	\$324.9	14.8%
2004	\$666.5	12.8%	\$450.0	16.9%	\$423.5	16.3%	\$279.0	21.8%	\$384.9	18.5%
2005	\$775.2	16.3%	\$530.0	17.8%	\$499.4	16.8%	\$340.0	19.9%	\$460.0	16.5%

*Source: Montgomery County Planning Department, M-NCPPC Research and Technology Center
Compiled from data provided by the State Department of Assessments and Taxation*

An index of housing affordability calculated by M-NCPPC reveals the effects of rising prices on affordability (Table 23). The index is based on changes in the median price of a home relative to the change in “affordability”, defined as 30 percent of median household income in the County. For the four year period 2001-2005, the index declined sharply. To illustrate, the index for affordability of existing single family housing in 2001 implies that the household with median income would have been required to spend 34.8 percent of its income to buy the median priced house. By 2005, the required house budget had risen to 48.5 percent. The choices for the median income household buying a house in 2005 were to spend a huge fraction of income on housing or buy a lower priced home. Many households undoubtedly raised their housing budget, while others bought a smaller home or were simply unable to buy. Even bigger changes occurred in the index for new housing, with prices of new homes pricing many households out of the market.

A Softening Housing Market The housing market slowed in the fall of 2005 and became much softer in the first half of 2006, in spite of the very strong County economy. Sellers used to feverish bidding above asking prices, multiple bids, and the opportunity to make quick capital gains are now confronting cautious buyers concerned about interest rates and anxious not to buy at the “top” of a speculative market. Increasing mortgage rates have deterred some buyers. The

result to date in 2006 has been sluggish sales, growing inventories of unsold homes and a halt to the runaway prices of recent years. Growing inventories in the condominium market have resulted in a number of projects being deferred. Part of the increasing number of units for sale reflects decisions by investors now trying to unwind investment decisions made over the last two to three years that were predicated on the assumption of continued rapid price appreciation. The role of speculative resale is evident metropolitan-wide, though it is less significant in the market in Montgomery County than in Northern Virginia.

Table 23
Montgomery County Housing Affordability Index
 Ability of a Median Income-Earning Household to Afford the Median-Priced Home

	<u>1990</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
New Single-Family	0.45	0.54	0.64	0.60	0.62	0.64	0.57	0.57	0.56	0.50	0.45	0.42
Existing Single-Family	0.69	0.84	0.88	0.90	0.96	0.93	0.84	0.86	0.83	0.75	0.67	0.62
New Townhouse	0.9	0.93	1.17	1.19	1.03	1.06	0.85	0.94	1.00	0.79	0.72	0.66
Existing Townhouse	1.12	1.43	1.51	1.54	1.64	1.62	1.55	1.60	1.49	1.27	1.10	0.96
Existing Condominiums								2.00	1.82	1.53	1.32	1.05
New Condominiums								1.27	1.27	1.15	1.07	0.79
All Condominiums			1.81	1.88	1.76	1.58	1.96	1.89	1.73	1.53	1.27	1.06

The higher the score, the more affordable the housing is. A score of "1.0" means the monthly cost of buying a home equals 30% of gross median income, where cost is based on housing price, mortgage rates, property taxes and insurance costs.

Source: M-NCPPC Research & Technology Center

The near term evolution of the County's housing market is uncertain. It is likely that prices will remain at "current" levels through 2006 as the inventory of unsold homes and units that investors may yet bring to the market are absorbed. However, current market conditions do not portend a significant change in the very favorable long term outlook for housing markets in the County, given the fundamentals underlying the County economy and the desirability of living here.

Housing prices over the long run will be affected by the rate of housing construction. Supply conditions in the new housing market have significantly changed. The rate of housing completions in the County has slowed in the last two years and is well below the Committee's annual target of 4,500 units, which has only been reached three times in the last decade. Housing completions fell to 3,700 units in 2005 and averaged 4,000 over the two year period 2004-2005; this contrasts to completions averaging 4,950 over the period 1999-2003 (Table 24). While the housing market in 2006 is characterized by buyer hesitancy translating to a temporary glut in houses offered for sale and adjustments in asking prices, the County still confronts the long run challenge of providing enough housing to meet demand, as noted above.

The County should develop a more aggressive strategy to expand the housing stock, including zoning changes that allow higher density development and the expansion of programs that require a higher fraction of work force housing to be included in new development. The selling prices for new units far exceeds prices of existing housing, implying that new development can finance associated public infrastructure needs. The Planning Board has made a priority of finding opportunities for adding housing by modifying sector plans and making zoning changes that encourage development and infill within the Master Plan. Redeveloping some older

shopping centers with mixed-use projects that include housing is an example. The revisions of the Growth Policy in 2003 no longer include development moratoriums, and provide somewhat more flexibility to allow added development when builders can finance infrastructure improvements required by the County. The Committee urges that these and other approaches to expand housing within the Master Plan be pursued.

<u>Year</u>	<u>Approvals</u>	<u>Permits</u>	<u>Completions</u>
1985	5,824	9,642	9,766
1986	3,323	12,026	10,366
1987	5,100	7,352	9,820
1988	4,177	6,533	8,397
1989	8,351	5,813	6,137
1990	5,392	4,198	3,270
1991	5,766	3,092	4,704
1992	1,843	3,564	2,944
1993	3,139	3,453	3,083
1994	2,393	3,962	2,854
1995	4,842	4,372	2,937
1996	5,052	3,721	3,114
1997	1,777	2,938	3,855
1998	2,891	4,401	3,200
1999	4,428	4,959	5,464
2000	2,527	4,113	4,178
2001	5,719	5,757	4,174
2002	4,750	4,936	5,484
2003	6,239	4,428	5,461
2004	7,419	3,821	4,274
2005	5,424	3,591	3,700

Source: M-NCPPC

Regulatory uncertainties Delays in the regulatory decision-making process are now playing a major role. In 2005, 5,424 units received site plan approval, a level that would support further growth, though below the average in recent years. However, residential permits declined to 3,800 units in 2004 and to 3,600 units in 2005, with very sharp declines after mid-2005. In the nine months from July 1, 2005 through March 31, 2006, permits fell by 59 percent from levels a year earlier. In the first three months of 2006, only 283 permits for new residential units were issued, a 77 percent decline from a year earlier. The dramatic reduction in the number of permits reflects both market conditions and the uncertainties in the regulatory environment, which are discussed further below. The collapse in permits and the likelihood that regulatory problems may persist for some time suggests that housing completions may be one-third lower in 2006 than in 2005, and will remain at below average levels in 2007.

Housing markets in 2005 through mid-2006 are being dramatically affected by the aftermath of allegations that hundreds of residential units in the

Clarksburg town center development were not built in accordance with approved site plans. The allegations prompted a comprehensive review of the overall site plan approval process, and the outcomes of the issues raised at Clarksburg are far from settled. An excellent and comprehensive review of issues at Clarksburg was conducted by the County Council's Office of Legislative Oversight ("*Fact Finding Review of the Clarksburg Town Center Project*," OLO Report 2006-3, November 8, 2005). The review states that regulatory oversight of the Clarksburg project was inadequate, inconsistencies in site plans submitted and approved were frequent, and construction outcomes were sometimes at variance with site plans. An arbitration settlement related to complaints against one major developer provides for \$14.5 million in investments to address planned services in the town center that were not built. Disputes with other developers over site plans, as well as a number of other issues, remain unresolved at the time of this report. Selected construction projects in other parts of the County are also being reviewed for compliance with site plans.

Changes in regulatory processes at Park and Planning are likely to have wider effects. As noted above, initial allegations at Clarksburg led to an extensive review by County agencies, a selective moratorium on new building permits and a more intense review of many ongoing building projects. The scope of this review represents a significant added work responsibility for the Planning Board. Concerns that inappropriate decisions were being made by staff with too little oversight by the Planning Board appear to have resulted in much greater involvement by the Planning Board and in far fewer decisions being made at the staff level. Anecdotal concerns are being expressed that long delays are now routine, and that decisions that were formerly made on a relatively predictable timetable now face unknown processes and outcomes. Decisions about preliminary plan approvals, site plan approvals, and zoning changing have slowed dramatically. Developers who previously praised Park and Planning as an extremely well-run organization -- skilled at balancing community concerns, but fair to developers and providing predictable processes and outcomes -- now express concern that a return to normal processing activities may take quite some time.

The challenge facing the Planning Board is significant. Replacing departing leadership, including the Director of the Planning Board, the Director of Planning, and other senior staff, is a difficult task. Effectively directing additional resources for regulatory oversight and developing transparent, credible, and effective decision-making and monitoring processes are also difficult challenges. Success will be very important, for it is critical that County zoning and permitting procedures, compliance, and project inspections are achieved without creating major new uncertainties for residents, businesses, and developers. Uncertainty and delay in decision-making will stretch out the life of construction projects, and at its worst deter investment and threaten the goal of continued expansion of the housing stock in the County. Citizens expect that the long established tradition of excellence and openness in regulatory processes, as well as compliance with regulatory decisions by developers, will always remain the hallmark of the County's development activity. The pace of housing expansion is very important to the future job growth in the County, and to housing availability and the rate of housing price inflation. The Committee recommends that renewed efforts to be made to reach housing targets.

Goal: Pursue zoning and permitting policies that result in housing completions of 4,500 units annually to support population and job growth targets.

PUBLIC SERVICES AND PUBLIC SECTOR CAPACITY

Income Tax Receipts

The County continues to enjoy very rapid growth in income tax receipts, reflecting strong growth in the economy. The State is also enjoying a huge surge in income tax revenues (Table 25). The rapid growth in personal income tax receipts has been a surprise at national, state, and local levels of government, with tax receipts growing at rates in excess of the growth in wage and salary income. Increases in capital gains income and rapid growth in business profits (reflecting a significant shift in the share of national income from labor to capital income) are all contributing to the rapid growth in personal income tax receipts.

Table 25
Income Tax Revenue
(\$ Millions)

<u>Year</u>	<u>County Total</u> <u>(\$Millions)</u>	<u>County % Growth</u> <u>(One Year)</u>	<u>State % Growth</u> <u>(One Year)</u>
FY95	446.2	1.3%	3.0%
FY96	480.8	3.1%	2.5%
FY97	544.3	13.2%	10.3%
FY98	602.8	10.8%	3.4%
FY99	689.2	14.3%	3.4%
FY00	761.1	10.4%	10.5%
FY01	812.4	6.7%	8.2%
FY02	867.0	6.7%	-7.1%
FY03	788.0	-9.1%	-1.4%
FY04	869.7	10.4%	7.9%
FY05	940.9	8.2%	11.5%
FY06 est.	1,033.0	9.8%*	10.3%**
FY07 est.	1,079.4	4.5%*	6.7%**

Source: Montgomery Department of Finance, OMB Schedule F2 in County Executive's Recommended FY07 Budget, and State of Maryland Bureau of Revenue estimates, March, 2006.

County data are income tax collections disbursed to County, which lag State collections by several months.

The County has a disproportionately high concentration of the State's business owners and other taxpayers with significant wealth, important drivers of the growth in income tax receipts. It is very likely that growth in income tax revenue in the County will be higher than predicted in both FY06 and FY07. The County's employment market is among the strongest economies in the State.

Goal: Maintain growth in income tax receipts consistent with income growth in the County.

Property Tax Base

The County's property tax base is expanding rapidly, reflecting large increases in housing prices and sharply rising assessments. Increases in housing prices reflect the extraordinary demand for property in the County and the capitalization of the County's economic success in the prices of properties. New construction also added to the base. Three years (2002-2004) of residential completions averaging 5,000 units annually at prices far exceeding the average price of existing housing have contributed to growth in the County's property tax base.

The residential property tax base is the fastest growing part of the overall tax base, increasing 8.9 percent in FY04 and 10.9 percent in FY05 (Tables 26-27). FY06 increases will likely be even higher. Because of the magnitude of housing price appreciation and the three year reassessment cycle, very large increases in the tax base are assured for many more years. The County projects increases in the property tax base of 13 percent in both FY07 and FY08 and of 12 percent in FY09.

The non-residential portion of the property tax base has grown at an approximately 6.5 percent rate over the five year period FY01-FY05, reflecting both new completions and rising assessments of existing properties. Non-residential completions will be lower in the period 2005-2007. However, market values of commercial properties continue to increase, and hence continued growth in the non-residential tax base is likely. Growth in the commercial base

Table 26
Growth in Components of the County Tax Base

<u>Year</u>	<u>Residential</u> <u>Real</u>	<u>Non-Residential</u> <u>Real</u>	<u>Personal</u> <u>Property</u>	<u>Total</u>
FY94	5.2%	-1.2%	1.6%	3.5%
FY95	3.2%	-5.7%	0.5%	1.2%
FY96	1.7%	-1.6%	4.2%	1.4%
FY97	2.3%	1.1%	7.7%	2.8%
FY98	2.6%	2.0%	-3.6%	1.8%
FY99	2.2%	2.9%	2.8%	2.4%
FY00	2.4%	4.1%	3.2%	2.8%
FY01	2.6%	6.8%	5.1%	3.6%
FY02	3.8%	7.8%	3.0%	4.6%
FY03	6.4%	5.7%	0.6%	5.9%
FY04	8.9%	6.1%	-6.2%	7.6%
FY05	10.9%	6.8%	-1.5%	9.6%

Source: Montgomery County Department of Finance

Goal: Achieve increases in the property tax base at least proportional to growth in income in the County, and promote increased growth in the commercial property tax base.

provides benefits to County residents by lowering tax rates on residential property. The 2003 Strategic Plan for Economic Development endorsed the strategy of promoting employment growth as a means of furthering growth in commercial property and the commercial property tax base. This remains an important long-term development goal.

Table 27
County Property Tax Base
Residential and Non-Residential Share

<u>Year</u>	<u>Residential</u> <u>Real</u>	<u>Non-Residential</u> <u>Real</u>	<u>Personal</u> <u>Property</u>	<u>Total</u>
FY86*	69.5%	17.8%	12.7%	30.5%
FY91*	66.3%	21.0%	12.7%	33.7%
FY92*	67.1%	20.5%	12.4%	32.9%
FY93*	68.5%	19.6%	11.9%	31.5%
FY94*	69.7%	18.7%	11.7%	30.4%
FY95*	71.0%	17.4%	11.6%	29.0%
FY96*	71.2%	16.9%	11.9%	28.8%
FY97*	70.9%	16.6%	12.5%	29.1%
FY98*	71.5%	16.7%	11.8%	28.5%
FY99*	71.4%	16.7%	11.9%	28.6%
FY00*	71.1%	17.0%	11.9%	28.9%
FY01*	70.5%	17.4%	12.1%	29.5%
FY02*	69.6%	18.0%	12.4%	30.4%
FY01**	75.9%	18.7%	5.4%	24.1%
FY02**	75.4%	19.4%	5.2%	24.6%
FY03**	75.7%	19.4%	4.9%	24.3%
FY04**	76.6%	19.1%	4.3%	23.4%
FY05**	77.6%	18.6%	3.8%	22.4%

Source: Montgomery County Department of Finance

** Shares are based on 40% full-assessment value for residential and non-residential real property.*

*** Shares are based on 100% full-assessment value for residential and non-residential real property after FY01*

Public Expenditures vs. Revenue Capacity

The issue of the appropriate level of public expenditures is complex, and a subject of continuing public debate. The County government continually strives to provide enhanced services, security, and support services of all sorts to an increasingly diverse resident population. The extraordinarily high quality of public services is deeply engrained in the expectations and experience of County residents. Meeting these expectations is expensive.

Recent Gains in Revenues The County's fiscal situation has dramatically improved, reflecting rapid growth in income tax revenues, large increases in property tax assessments, and State budget surpluses that have allowed the State to increase transfers to local governments in FY06 and FY07. The County has consistently underestimated revenues from income, recordation, and transfer taxes in recent years. As a result, revenues have proven to be far in excess of estimates, providing an unexpected windfall to the County at the end of each fiscal year. FY06 income tax revenues at the time of this report are estimated to be \$1.032 million, versus \$948 million budgeted; the difference of \$88 million represents more than 2 percent of the County's budget. Real property transfer taxes were underestimated by approximately \$33 million in FY06. FY06 expenditures are now estimated to be \$3.590 billion, a 7.9 percent increase, and approximately 1 percent more than the budget initially approved for this fiscal year (Table 28).

Table 28						
Trends in County Public Expenditures and Tax Revenues					Expenditure vs. Revenue Capacity	
	% Change in	% Change	% Change in	% Change in	Expenditures	Revenues
Year	Expenditures	Revenue	Tax Revenue	Tax Revenue	Million (\$)	Million (\$)
FY 94	7.1%	10.8%	15.6%	3.5%	1,702	1,819
FY 95	5.6%	2.7%	1.3%	1.4%	1,798	1,868
FY 96	5.8%	2.9%	3.1%	1.2%	1,902	1,922
FY 97	4.6%	7.8%	13.2%	2.8%	1,940	2,072
FY 98	5.7%	7.4%	10.8%	1.8%	2,101	2,224
FY 99	8.2%	7.9%	14.3%	-0.7%	2,258	2,399
FY 00	4.7%	4.6%	10.4%	4.3%	2,365	2,509
FY 01	7.5%	4.1%	6.7%	2.1%	2,542	2,612
FY02	6.4%	8.4%	6.7%	4.0%	2,705	2,832
FY03	8.2%	1.4%	-9.1%	6.1%	2,926	2,870
FY04	5.5%	12.5%	10.3%	6.3%	3,089	3,149
FY05	7.9%	9.2%	8.2%	8.7%	3,327	3,437
FY06 Approved	7.0%	2.6%	0.8%	3.2%	3,561	3,527
FY06 Estimated	7.9%	8.2%	9.8%	3.3%	3,590	3,720
FY07 Rec.	8.1%	3.4%	4.5%	4.0%	3,882	3,846

Source: Montgomery County Recommended Operating Budget, FY07
FY07 expenditure total of \$3,882 million is the approved budget.

The County projects a 4.5 percent increase in income tax revenues in FY07 from its current estimate of FY06 revenues, which is likely to again be an underestimate, setting the stage for yet another revenue windfall (Table 28). Unexpected year-end windfalls are being carried over each year, making it easier to budget higher expenditures in the following year.

The increasing property tax base also adds to the County's "revenue capacity". However, actual property tax revenues are held down by the County's Charter limits. The County stayed within the Charter limit until FY04, but voted to exceed it in FY04 and FY05 when growth in County revenues slowed. The FY06 and FY07 budgets returned to within the Charter limits, with property tax reductions of \$86 million in FY06 and \$128 million in FY07. Property tax revenues increased by only 3.3 percent in FY06 (after an 8.7 percent increase in FY05 when the Charter limit was overridden) and are projected to increase by 4 percent in FY07. The County has been able to reduce rates to mitigate a substantial proportion of possible rate increases implied by the rising tax assessments.

The property tax relief granted in FY07 yields large tax savings: each homeowner receives a tax credit of \$221 on their tax bill, plus a five cent reduction in the tax rate. The owner of a home assessed at \$440,000 receives tax relief of \$441. Tax credits targeted to lower income owners represent even more substantial tax reductions. Homeowners with incomes below \$64,000 receive added relief of \$803 on the first \$300,000 in assessed value⁴.

Expenditures have increased at an 8 percent average annual rate over the three years FY05-FY07, and by 8.1 percent in the approved FY07 budget (Table 28). Budget increases are broadly distributed across most major categories of the County's budget (Table 29). This rate of increase likely exceeds the rate of income growth in the County as well as the growth in wage and salary earnings⁵.

Rising Compensation Costs Increases in the County budget are directly tied to increases in employment compensation costs of the County's workforce, the combination of an increase in employee work years in the County and rising compensation and fringe benefit costs. Employee compensation costs account for 80 percent of the County's total operating budget.

Compensation costs are now increasing rapidly, continuing a trend of many years during which compensation levels for County workers have steadily increased faster than private sector pay⁶. Total compensation in the County is projected to increase 9.1 percent in FY07, with compensation increases of 7.4 percent for MCPS employees, 12.3 percent for County government employees, and 9-10 percent for M-NCPPC and Montgomery College staff. Wage increases reflect three-year union agreements that cover the FY04-FY07/ FY05-FY08 time periods, together with roughly comparable wage benefits for County workers who are not

⁴ Montgomery County Council Press Release, "Council Announces \$3.9 Billion Budget That Puts Schools, Transportation, Property Tax Relief First." (May 18, 2006.) Despite the fact that property tax rates were significantly reduced in both FY06 and in FY07, many taxpayers are likely unaware that this tax relief has been enacted. The property tax assessment is an extremely visible sign of a "tax" confronting households, who each three years witness a huge increase in their assessment. Even with property tax rate reductions enacted in the FY06 and FY07 budgets, many taxpayers undoubtedly perceive property taxes out of control.

⁵ Data on resident income at the county level is reported by the Department of Commerce with a two-year lag. As one simple approximation of labor market earnings, the rate of growth of wage and salary earnings of persons working in Montgomery County averaged approximately 6.7 percent annually over the last several years.

⁶ Memorandum to Management and Fiscal Policy Committee, County Council, "Compensation and Benefits for All Agencies", by Stephen B. Farber, Council Staff Director, April 13, 2006; Montgomery County Proposed Operating Budget and Public Services Program, FY07-FY12, "Workforce/Compensation."

covered by union agreements. Union agreements generally provide general wage adjustments of 3 - 4 percent annually, plus annual service increments of 3.5 percent (employees with 20 or more years of service who are no longer eligible for annual service increments receive 2 percent annual longevity increments). Approximately two-thirds of County employees are eligible for annual service increments. Certain classes of employees are also eligible for performance bonuses.

Table 29
Montgomery County Expenditures - Operating Budget (\$ Millions)

<u>Category</u>	<u>FY 01</u>	<u>FY05</u>	<u>FY06 Estimated</u>	<u>FY07 Recommended</u>	<u>% Change FY96 - FY01</u>	<u>%Change FY01-FY04</u>	<u>%Change FY05-FY06</u>	<u>%Change FY06- FY07</u>
General Government	82	103.0	112.20	127.30	8.8%	16.3%	8.9%	13.5%
Public Safety	270	378.4	428.90	468.60	32.7%	21.1%	13.3%	9.3%
Public Works and Transportation	231.4	285.7	285.50	308.80	4.7%	10.4%	-0.1%	8.2%
Transportation Public Works and Transit Services	58.5	64.0	58.60	64.70	32.3%	-1.4%	-8.4%	10.4%
Parking District Services	68.7	20.6	23.70	24.70	-33.8%	21.1%	15.0%	4.2%
Solid Waste Services	14.9	105.5	104.50	105.80	-4.4%	27.5%	-1.0%	1.2%
Health & Human Services	89.2	95.6	98.80	113.60	18.5%	7.3%	3.3%	15.0%
Culture & Recreation	177.1	200.9	223.60	237.80	72.8%	12.7%	11.3%	6.4%
Community Development and Housing	55.7	58.6	66.00	73.00	24.9%	5.9%	12.6%	10.6%
Other	52.6	69.8	81.50	71.90	496.2%	13.5%	16.8%	-11.8%
Subtotal	82.2	137.4	170.80	174.60	0.6%	39.8%	24.3%	2.2%
Debt Service	951.3	1,241.0	1,376.50	1,470.30	28.7%	17.5%	10.9%	6.8%
Montgomery County Public Schools	159.2	201.1	212.20	219.90	25.8%	24.7%	5.5%	3.6%
Montgomery College	1,220.7	1,620.20	1,713.70	1,839.20	39.0%	23.0%	5.8%	7.2%
M-NCPPC	128.5	167.6	179.80	217.80	34.7%	33.0%	7.3%	21.1%
Total - All Agencies	82.8	97.2	108.20	115.30	24.5%	11.4%	11.3%	6.6%
	<u>2,542.5</u>	<u>3,327.1</u>	3,590.50	3,882.00	33.3%	21.2%	7.9%	8.1%

Source: Montgomery County Recommended Operating and CIP Budgets, FY07

FY07 expenditure total of \$3,882 million is the approved budget. Expenditure subcategories for FY07 are from the recommended budget. FY07 revenue data is from the recommended FY07 budget.

Analysis by the County Council of public sector pay in the region since 1996 indicates that County employees are paid at levels that are at the top of surrounding comparable high-income jurisdictions, both in pay levels and recent annual increments. The analysis also stresses that competition to recruit and retain a high-quality workforce will continue to present a challenge, as competitive pressures from surrounding jurisdictions to attract employees continue to increase.

The number of full-time equivalent County employees (FTEs) per 1,000 residents has been increasing since FY99 (with the exception of the period FY03 and FY04), and FTEs per resident are projected to be 13 percent higher in FY07 than in FY98. This increase is most rapid in the area of public safety. To illustrate, of the total increase of 361 FTEs in the tax-supported FY07 budget, more than half (208) were accounted for by staffing increases in the Departments of Corrections, Police, and Fire and Rescue. In absolute numbers, County FTEs will increase 3.1

percent in FY07; MCPS, which represents about 60 percent of all County employees, will see an increase in work years of 3.3 percent.

While current revenue windfalls presently support rapid expenditure growth, a return to more moderate spending growth in the County's operating budget seems likely to be required in the near future. Restraining future compensation increases will clearly involve difficult decisions in setting future wages and promoting greater worker productivity. The Committee continues to recommend that the County reduce the rate of growth in the operating budget, shifting resources to capital budgets and especially to transportation infrastructure. Reducing the income tax rate to pre-recession levels should also be considered. This recommendation is made notwithstanding the increase in the County's capital budget recently approved, described below.

Capital Budget The County's recently approved capital budget represents very good news. The County Council approved an increase of 24 percent to the biennial capital budget for the period FY07-12 over the prior (FY05-11) budget, a growth rate exceeding the operating budget (Table 30). The budget continues past trends of devoting the largest portion of capital investments to education, with proposed spending increases of 25.7 percent for MCPS and 38.4 percent for Montgomery College. The capital budget for M-NCPPC also increased by 15.8 percent. In contrast, the remaining functions of government (i.e., the County Government portion of the budget) collectively receive a budget reduction of 5.3 percent. The transportation budget was increased 23 percent over the prior capital budget, the largest increase in transportation funding for many years, as described in the following section.

Table 30
Montgomery County Capital Improvements Budget (CIP) - (\$ Millions)

	FY01-FY06	FY03-FY08*	FY05-FY10	FY07-FY12*	Percent*
<u>County Government</u>	<u>Amended</u>	<u>Amended</u>	<u>Amended</u>	<u>Approved</u>	<u>Change</u>
General Government	366,665	222,023	114,902		
Public Safety	78,773	101,762	182,655		
Transportation	408,403	433,416	529,024		
Health and Human Services	874	0	2,596		
Libraries and Recreation	72,712	87,008	132,501		
Conservation of Natural Resources	44,687	64,816	54,185		
Housing and Community Development	7,831	8,822	5,081		
Solid Waste Management			12,023		
Subtotal: County Government	979,945	917,847	1,033,027	1,232,047	19.3%
<u>Other Agencies</u>					
MCPS	697,771	637,106	933,515	1,173,478	25.7%
Montgomery College	120,579	114,946	235,610	326,061	38.4%
M-NCPPC	132,608	117,782	147,338	170,653	15.8%
WMATA	40,204	21,088	3,800	17,094	449.8%
Housing Opportunities Commission			1,500	7,250	483.3%
Revenue Authority			33,575	41,378	23.1%
Subtotal: Other Agencies	991,162	890,922	1,355,338	1,735,894	28.1%
Total Tax Supported Agencies	1,971,107	1,808,769	2,388,365	2,967,801	24.3%

*FY07-12 data is approved budget levels: budget detail for agencies unavailable at the time of this report.

Source: Montgomery County Approved Operating and CIP Budgets, FY02, FY04, FY06 and FY07.

The County's Approved CIP Budget was \$2.8 billion in total expenditures, including \$653 million for transportation.

The Committee would award the County an “A+” grade for revenue capacity, but awards a somewhat lower overall grade reflecting its concerns about the challenges in restraining overall spending growth.

Goal: Public expenditure growth should reflect the long term revenue capacity implied by growth in personal income with stable tax rates, and County budgets should significantly increase the share of public spending that is devoted to capital expenditures.

Transportation Capital Expenditures

Improving the County’s transportation system has long been the single biggest challenge to improving the quality of life in the County and the environment for sustained economic growth. With the FY07-FY13 capital budget, the County has taken the most significant positive steps toward investing in an improved transportation system since the late 1980s, and certainly since this Committee has been issuing its reports. A large increase in the transportation component of the County’s capital budget in FY07-FY13, together with an aggressive approach at negotiating and partnering with the State to obtain additional matching funds, represents a major commitment to finance added infrastructure. The FY07 budget could mark the beginning of a major turning point in the County’s transportation future. Equally importantly, the ICC has now received final environmental approvals at the federal level, marking the completion of approvals at all levels of government and setting the stage for construction to begin in the fall of 2006.

The expansion of capital funding for transportation in the recently approved capital budget represents a major milestone. The CIP budget for FY07-FY13 includes a large increase in funding for additions to highway and transit capacity. Transportation capital spending was increased to approximately \$654 million, a 23 percent increase over the prior budget. Previous priorities in transportation budgets had been safety, maintenance of infrastructure, improved operational efficiency (signaling, lane marking, etc.), and added capacity – more or less in that order. With relatively limited funds made available over the last 10 years, little was spent on new highway capacity. The increase in the FY07 capital budget reflected leadership from both the County Executive and the Council, and a shared viewpoint that the County needed to devote additional resources that would both fund new capacity and would advance planning and construction of needed projects forward in time. Rearranging the timing of expected capital outlays for County schools, together with floating \$80 million of 10-year revenue bonds to be paid off by revenues from liquor sales in the County, yielded an additional \$160 million that was added to the transportation budget.

This budget increase provides the ability to address deficiencies in State roads in the County, the major bottleneck in the County’s transportation system. The principal County highway deficiencies are inadequate major roads and congested major intersections in the State road system. The County has received insufficient funding from the State and has fared poorly relative to other jurisdictions since about 1990. Prior to that date, the County used its own revenues to negotiate with the State for added funds, implicitly provided ‘cost-sharing’ to the State for State road projects. After 1990, County highway funding was significantly reduced and the County’s effectiveness in negotiating with the State was significantly set back, while other

jurisdictions became much more successful in negotiations with the State, in part by adopting the County's 'cost-sharing' approach.

The County has been far more effective in recent years. It now submits a single request to the State for road funding that has been agreed upon by the County Executive and County Council. The FY07 budget decisions now provide the necessary monies needed for more effective negotiation with the State. The County is requesting \$400 million of additional State funding to match its \$160 million contribution over the next six years, comprised of projects that largely match the priorities and projects previously contained in its November 2005 request to the State. New funds will include completion of the Montrose Parkway interchange at Route 355 and Randolph Road. Other major projects where both planning and construction funding are targeted include a highway interchange at Georgia Avenue and Randolph Road; a new 270 Interchange at Watkins Mill Road, a critical part of improved service in Gaithersburg; completion of Route 124 at the Mid-County Connector; a realignment of Georgia Avenue (Brookville Bypass); an interchange at Route 97 and Norbeck Road; and an enlargement of the Glenmont Metro station parking garage, which is now filled to capacity by 7:30 a.m.

Major intersection projects are expensive projects largely financed by State and federal funds (for example, the I-270 interchange is \$143 million); the County's ability to partner with the State in providing immediate funding needed by the State will hopefully support initiation of these projects much sooner. The I-270 interchange at Watkins Mill Road recently approved by the City of Gaithersburg reflects a successful partnership between the City, County, and major developers, who provided a majority of the land (valued in excess of \$40 million) needed for the interchange.

The InterCounty Connector (ICC) As noted above, final federal approvals of the ICC will permit construction to begin in the fall of 2006, with a projected 2010 completion date. Approximately 80 percent of the project's \$2.3 billion capital cost will be funded by the federal government and the rest will be financed by State revenue bonds to be amortized by tolls. The level and structure of tolls is still under consideration; tolls are likely to be in the range of 17-20 cents per mile, implying a toll of upwards of \$3.50 for the entire 18 mile trip. Completing the ICC will have the single largest impact on congestion in the County of any transportation investment strategy that has been considered. Long-term planning evaluations have focused on outcomes for 2020 and beyond, with projected congestion improvements "limited" because of increased travel demand over the long run. However, very significant improvements will occur immediately after completion in 2010, as traffic is diverted from local east-west roads and the Beltway to the ICC.

Increasing Transportation Capacity at Clarksburg One other transportation issue that is receiving increasing attention in the County is the capacity needed to serve new demand associated with development at Clarksburg. The County's Department of Public Works and Transportation had virtually no role in planning capacity to serve Clarksburg, and little County money was earmarked to meet anticipated needs. Only limited roadways were included in the development plans, most oriented toward facilitating traffic flow into and within the community. However, little capacity was planned to provide service for Clarksburg residents heading to destinations to the south in the County, which will account for an overwhelming fraction of trips

for employment, retailing, and other purposes. Roadway infrastructure was the responsibility of developers, who were responsible for initiating construction at various dates spanning the entire development. To date, transportation investments are incomplete and inadequate. It is likely that the County will be required to make significant commitments to roadway service to the south of Clarksburg. The County is about to complete a one-mile, four lane extension connecting with 270. Stringtown Road through the center of Clarksburg will remain a major bottleneck until widened.

The County's transportation challenges are long-term in nature, not unlike those of many major suburban employment centers in the nation's largest metropolitan areas, all of which confronting rising transportation costs and difficulties in providing infrastructure to match growing travel demands. The recent increases in capital funding for transportation do not represent the final actions needed to solve transportation challenges for all time, but rather a major first step to provide improved service over the next 10 plus years. Execution of decisions initiated this year and a continued commitment to fund transportation investment at a higher level in subsequent capital budgets will yield significant transportation benefits over the coming decade. The Committee has significantly increased its grade on transportation infrastructure based on this recent commitment to increased transportation infrastructure funding.

Goal: Enact policies to implement the *Go Montgomery!* transportation policy, including accelerating planning and the initiation of projects, enacting policies that provide long term financing to complete long term objectives, and aggressively promoting development of the InterCounty Connector.

Economic Development Report Card Committee 2005

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